

**BEFORE THE HEARING OFFICER  
OF THE TAXATION AND REVENUE DEPARTMENT  
OF THE STATE OF NEW MEXICO**

**IN THE MATTER OF THE PROTEST OF  
SHAMROCK FOODS COMPANY  
TO ASSESSMENT ISSUED UNDER LETTER  
ID NO. L2114947456**

**No. 10-17**

**DECISION AND ORDER**

A formal hearing on the above-referenced protest was held on May 28, 2009, before Monica Ontiveros, Hearing Officer. The Taxation and Revenue Department (“Department”) was represented by Patrick Preston, Special Assistant Attorney General. On June 10, 2009, the Department filed its Memorandum of Law and on August 17, 2009, Shamrock Foods Company (“Taxpayer”) filed its argument. Shamrock Foods Company was represented by Gerald Gulick, Corporate Controller. Based on the evidence and arguments presented, IT IS DECIDED AND ORDERED AS FOLLOWS:

**FINDINGS OF FACT**

1. Shamrock Foods Company (“Taxpayer”) is an Arizona “C” corporation doing business in New Mexico.
2. Gerald Gulick represented Taxpayer at the hearing and is the Corporate Internal Auditor for Taxpayer.
3. The Department assessed Taxpayer on May 16, 2008, in gross receipts tax in the amount of \$113,916.28 in principal, \$11,391.79 in penalty and \$32,919.50 in interest for a total of \$158,227.57 for the tax period of January 31, 2001 through February 28, 2007.
4. On June 26, 2008, Taxpayer filed a written protest to the assessment, which was accepted by the Department under a retroactive extension of time granted pursuant to NMSA 1978,

Section 7-1-24 (2003).

5. Taxpayer specializes in the manufacturing and distribution of quality food and food-related products.

6. Taxpayer delivers food and food-related products to businesses in Albuquerque, Deming, Gallup, Grants, Las Cruces, Roswell, Ruidoso, Santa Fe, Truth or Consequences, Farmington and out of state locations.

7. On September 11, 2007, the Department conducted an audit of Taxpayer for the audit period of January 2004 through February 2007. The Department used the sample method to audit Taxpayer.

8. In the audit, the Department determined that Taxpayer was correctly reporting the total number of gross receipts and that there were no exceptions noted for underreporting.

9. Taxpayer agreed to allow the auditor to verify the reported deductions by using a sample basis and applying a percentage of error (POE). The POE was calculated by dividing the total deductions (nontaxable portion) from the sample by the disallowed deductions taken from the sample.

10. The POE was determined to be 2.0007%, which was calculated by using the disallowed deductions of \$553.21 (Abrahams); \$10.96 (Canton Café); \$301.73 (JC Market and Deli); \$315.90 (Matilda's); \$69.11 (Luna's); \$7.00 (King Dragon); \$97.45 (Sundial Deli Market); \$1,444.92 (SI Italian Bistro); and \$79.51 (Timeout Travel Center), for a total amount of the disallowed deductions of \$2,879.79. The total amount of deductions (nontaxable portion) from the sample invoices was \$143,942.70.

11. The Department determined the amount of gross receipts tax due by applying the

POE to the deductions reported per CRS-1 returns, extracting the applicable tax rate based on the location from the amount, and then arriving at a net disallowed deduction. The applicable gross receipts tax amount was applied to this amount. Department Exhibit #2, page AN4.

12. Taxpayer did not dispute the application of a POE or the use of the sample method to arrive at the amount of tax liability due to disallowed deductions. Department Exhibit #2, page AN2.

13. Taxpayer conceded that some of the invoices within the sample used to calculate the POE were representative of the sample itself. Specifically, Taxpayer did not dispute the portion of the disallowed deductions sample containing the invoices of \$10.96 (Canton Café); \$301.73 (JC Market and Deli); \$69.11 (Luna's); \$7.00 (King Dragon); \$97.45 (Sundial Deli Market); and \$79.51 (Timeout Travel Center).

14. Taxpayer disputed that certain invoices should be included within the sample used to calculate the POE because they were unique and not representative of the sample itself. Taxpayer argued that the disallowed deductions in the amounts of \$315.90 (Matilda's); \$1,444.92 (SI Italian Bistro); \$553.21 (Abrahams) should be removed from the sample because it skewed the POE.

15. Taxpayer produced an expired 1982 Series Type 2 NTTC during the 60 day notice period to substantiate the deductions taken for the invoices for Matilda's and Abraham's. Taxpayer produced the correct Type 2 NTTCs for the invoices for Matilda's and Abraham's after the 60 day letter expired. Department Exhibit #2, page AN3.

16. The Department issued its 60 day letter on March 19, 2007 with an expiration date

of May 18, 2007. Department Exhibit #1.

17. Taxpayer argued that the invoice from SI Italian Bistro should be removed from the sample because Taxpayer had evidence that SI Italian Bistro was also known as Beth's Bakery, and it had a Type 2 NTTC from Beth's Bakery that was produced timely to the Department.

18. Taxpayer provided a Type 2 NTTC for Beth's Bakery during the 60 day notice period. Department Exhibit #2, page AN3.

19. Taxpayer provided a Type 2 NTTC for SI Italian Bistro after the 60 day notice period had expired. Department Exhibit #2, page AN3.

20. Taxpayer argued that the POE should be reduced by 80.4% or by \$127,200 in invoices. Taxpayer's Protest, page 1.

21. Taxpayer made a payment of \$31,699.62 on August 25, 2008. Department Exhibit #6.

22. The Department argued at the hearing that a 20% penalty or \$22,783.58 should be applied to the Taxpayer's outstanding principal of \$113,916.28. Department Exhibit #5.

## **DISCUSSION**

The issue to be determined is whether the disallowed deductions in the amounts of \$315.90 (Matilda's), \$553.21 (Abrahams), and \$1,444.92 (SI Italian Bistro) should be removed from the sample because they were not representative of disallowed deductions from the sample of the deductions used to calculate the percentage of error.

### **Burden of Proof.**

NMSA 1978, Section 7-1-17 (2007) provides that any assessment of taxes made by the

Department is presumed to be correct. Where an exemption or deduction from tax is claimed, the statute must be construed strictly in favor of the taxing authority, the right to the exemption or deduction must be clearly and unambiguously expressed in the statute, and the right must be clearly established by the taxpayer. *Wing Pawn Shop v. Taxation and Revenue Department*, 111 N.M. 735, 740, 809 P.2d 649, 654 (Ct. App. 1991). Accordingly, it is Taxpayer's burden to present evidence and legal argument to show that it is entitled to an abatement, in full or in part, of the assessment issued against it. When a taxpayer presents evidence sufficient to rebut the presumption, the burden shifts to the Department to show that the assessment is correct. *See MPC Ltd. v. N.M. Taxation and Revenue Dep't.*, 2003-NMCA-021, ¶ 13, 133 N.M. 217, 62 P.3d 308.

The Department conducted an audit of Taxpayer using the sample month basis method to audit Taxpayer. The Department's sampling software RAT-STATS selected nine random numbers and one spare number for the audit period of January 2004 through February 2007, with the assigned or selected sample months of July 2004, January 2005, March 2005, July 2005, August 2005, December 2005, February 2006, July 2006 and November 2006. Taxpayer provided all the applicable returns and any nontaxable transaction certificates (NTTC) for the reporting months selected. Department Exhibit #2, page AN2.

In the audit, the Department determined that Taxpayer was correctly reporting the total number of gross receipts and that there were no exceptions for underreporting. However, the Department determined that the Taxpayer was deducting receipts from the sales of food and food-related items without the proper NTTC or without an applicable statutory deduction or exemption based on a sampling of deductions. Department Exhibit #2, page AN3. Taxpayer agreed to allow

the auditor to verify the reported deductions by using a sample basis and applying a percentage of error (POE). Department Exhibit #2, page AN2. The POE was calculated by dividing the total deductions (nontaxable portion) from the sample by the disallowed deductions from the sample. Department Exhibit #2, page C3.13.

To verify the reported deductions, the Department selected 280 random numbers from the total sales data from the audit period. It, then, assigned random numbers to the sales invoices. Department Exhibit #2, page AN2. The POE was determined to be 2.0007%, which was calculated by using the disallowed deductions of \$553.21 (Abrahams); \$10.96 (Canton Café); \$301.73 (JC Market and Deli); \$315.90 (Matilda's); \$69.11 (Luna's); \$7.00 (King Dragon); \$97.45 (Sundial Deli Market); \$1,444.92 (SI Italian Bistro); and \$79.51 (Timeout Travel Center), for a total amount of the disallowed deductions of \$2,879.79. Department Exhibit #2, page C3.13. The total amount of deductions (nontaxable portion) from the sample invoices was \$143,942.70. Department Exhibit #2, page C3.13.

**Disallowed deductions of \$315.90 - Matilda's and \$553.21 – Abrahams.**

Taxpayer raises a number of arguments in its protest. First in dealing with the disallowed amounts \$315.90 and \$553.21, the Department disallowed these amounts because Taxpayer only provided 1982 Series Type 2 NTTCs to support the nontaxable sales. Taxpayer argued that the law was confusing as to whether the 1982 Series Type 2 NTTCs were disallowed and that the Department should allow and accept the 1992 Type 2 NTTCs even though they were provided outside of the 60 day notice period.

At the time of these transactions, the applicable provision of Section 7-9-43 provided that a

deduction would be disallow if the seller was not in possession of the NTTC within the 60 day notice period. The commencement of the audit was March 19, 2007. Department Exhibit #1. The auditor provided Taxpayer with a 60 day letter which required Taxpayer to be in possession of all NTTCs, 60 days from the date of the notice. Department Exhibit #1, page 3.

Taxpayer argued that it did not realize that that the 1982 NTTC series was void or not valid. The Department presented substantial evidence indicating that it engaged in an active campaign to inform the public that taxpayers were required to obtain new nontaxable transaction certificates for any nontaxable transactions that occurred on or after January 1, 1992. Department Exhibit #4. These transactions occurred well after January 1, 1992. The Department provided information through the print media, electronic media, alternate media and separate mailings, including information in the CRS Filers Kit that Taxpayer received. Department Exhibit #4. Mr. Gulick testified that he was a Bachelor's Degree in accounting from Notre Dame and a Masters degree from the University of Southern California, but that his office was headquartered in Arizona. He also testified that he had worked for Taxpayer since 1982 and that he is a certified public accountant licensed in Arizona. The argument made by Taxpayer does not present a sufficient basis for removing the disallowed deductions from the sample.

Taxpayer also argued that there is no statutory provision that precluded the use of the old series of NTTCs and therefore it should be allowed to use the old series of NTTCs. The disallowance of the deduction is based upon the 1991 amendments to Section 7-9-43. Laws 1991, Ch. 9 §29, effective July 1, 1991, enacted a new subsection D to Section 7-9-43 which provided that, "[A]fter January 1, 1992, any nontaxable transaction certificate issued prior to that date *shall be void*."

(emphasis added). Thus, the law clearly required taxpayers to produce NTTCs in the 1992 series to properly support the deduction. The argument made by Taxpayer does not present a sufficient basis for removing the disallowed deductions from the sample. The Department's use of the disallowed deductions of \$315.90 - Matilda's and \$553.21 - Abrahams was proper in calculating the POE.

**Disallowed deduction of \$1,444.92 - SI Italian Bistro.**

Taxpayer argued that the deduction of \$1,444.92 for food products sold to SI Italian Bistro, d/b/a as Sweet Indulgence Café, d/b/a Beth's Bakery should be allowed and removed from the sample because Taxpayer believed that SI Italian Bistro was the same company as Beth's Bakery. Taxpayer made the argument that considering the facts there was no way for it to know that SI Italian Bistro and Beth's Bakery were different entities. Taxpayer presented a timely Type 2 NTTC to the Department to support the deduction of sales for resale pursuant to NMSA 1978, Section 7-9-47 for its sales to Beth's Bakery. Taxpayer Exhibit #B. According to Taxpayer, Beth's Bakery, Sweet Indulgence Café and SI Italian Bistro were the same company, but with different names.

The Department argued that SI Italian Bistro and Beth's Bakery were separate companies registered separately with the Department with different federal identification numbers. Department Exhibit #2, page AN3. In the Department's audit, it states that SI Italian Bistro began its business in May 2005 and that Beth's Bakery ceased operations in August 2005. Therefore, at least as to Beth's Bakery and SI Italian Bistro, the businesses are separate and distinct. The Department took the position that Taxpayer should have timely presented a Type 2 NTTC for its sales to SI Italian Bistro and the Type 2 NTTC from Beth's Bakery was not acceptable because the



sale was to SI Italian Bistro.

To support its argument that its belief was reasonable that Beth's Bakery was doing business as SI Italian Bistro, Taxpayer presented evidence that Jeremy E. Hixon owned Beth's Bakery and owned Sweet Indulgence Café. Taxpayer introduced a Shamrock Foods new account form dated May 24, 2004, that listed Mr. Hixon as the owner of Beth's Bakery, d/b/a Sweet Indulgence Café. Taxpayer Exhibit #A. The address of Beth's Bakery was listed as 1702 El Paseo, Las Cruces, New Mexico. Taxpayer Exhibit #A. The Department issued a Type 2 NTTC to Beth's Bakery on May 12, 2003, and Beth's Bakery issued the NTTC to Shamrock Foods on May 24, 2004. The address for Beth's Bakery is listed on the NTTC as 1701 El Paseo, Las Cruces, New Mexico 88001. Taxpayer Exhibit #A. There was no explanation as to why the address on the Type 2 NTTC was one digit off of the information on Taxpayer's records.

In addition, Taxpayer presented evidence that Sweet Indulgence Café changed its address on or around October 17, 2005 to 523 E. Idaho, Las Cruces, New Mexico. Taxpayer Exhibit #C. (This evidence is contrary to the Department's statement in the audit which states that Beth's Bakery ceased operation in August 2005.) The owners of Sweet Indulgence Café are listed as Jeremy Hixon and Sara Hixon; the same owners as Beth's Bakery. Taxpayer Exhibit #C. Mr. Gulick testified that Exhibit C was the backside of Exhibit A. Mr. Gulick testified that the invoice at issue was dated October 6, 2006. Taxpayer also introduced an e-mail from Patricia King, Credit Manager at Shamrock Foods Company. Mr. Gulick testified that Ms. King was a key player. Ms. King states in her e-mail that "I brought you the detail for S.I. Italian Bakery. The corporate entity has not changed. Only the dba has changed through the years. Their tax number nor ownership

has not changed. Only the name of the building.” Taxpayer Exhibit #D. The e-mail is dated July 17, 2007. Taxpayer Exhibit #D. Mr. Gulick testified that the reasonable and prudent standard required that the only implication that could have been drawn was that Beth’s Bakery, Sweet Indulgence Cafe and SI Italian Bistro were all the same company and there was no reason for Taxpayer to believe that these three companies were separate and distinct companies. Mr. Gulick testified that Taxpayer dealt with Jeremy Hixon as the same owner of all three companies. Mr. Gulick also testified that Taxpayer had assigned all three companies the same customer identification number. Finally, Taxpayer provided a statement from Ms. Marybeth Higgins which states that “Beth’s Bakery has been operating as SI Italian Bistro since August 3, 2005. Before this date Beth’s Bakery/Sweet Indulgence was the business name.” Taxpayer Exhibit #E. The statement from Ms. Higgins includes a copy of a business card that indicates that she is the Pastry Chef/Owner of SI Italian Bistro and Bakery, LLC located at 523 E. Idaho, Las Cruces, New Mexico. Taxpayer Exhibit #E.

Taxpayer presented evidence that rebutted the presumption that at the time of the transactions Beth’s Bakery and SI Italian Bistro were separate companies, and Taxpayer presented sufficient evidence to show that Taxpayer had a reasonable belief that they were the same company. Mr. Gulick was a credible witness and it seems clear from the testimony, that Taxpayer had a belief that it did not need a NTTC from SI Italian Bistro because it believed that the NTTC that it had was sufficient. The Department did not present any clear evidence, other than the information presented in the audit, supporting its position that these three companies were separate and distinct companies, and had registered as separate companies.

Most importantly, the Department did not present testimony as to whether during the audit, the Department could have used another sales invoice to calculate the percentage of error or whether this sales invoice was fairly representative as not to be excluded from the sample. A sales invoice that was not representative of the sample could skew the percentage of error calculation. The testimony presented centered on whether the deductions were properly disallowed, and no mention was made about whether another invoice could have been used to calculate the POE. Taxpayer objected to the use of the invoice in the sample during the audit, and at the hearing it objected to the invoice being used. At the hearing Taxpayer argued that to include the SI Italian Bistro invoice in the POE and apply it to all other months skews the POE and assesses an improper amount of tax. Taxpayer's methodology in calculating the correct amount of tax liability was that the liability should be reduced by 80.4% or by \$127,200 if all three disallowed deductions were removed from the POE. Taxpayer's Protest, page 1. Mr. Gulick testified that there were 13 transactions disallowed and he used a percentage in calculating how much Taxpayer owed. The Department's methodology is the correct methodology to use. There is sufficient testimony and evidence in the record to support the removal of the disallowed deduction or invoice for SI Italian Bistro in the amount of \$1,444.92 from the calculation of the POE.

Taxpayer made a payment which was to be applied to the principal amount of tax. At the hearing, the Department did not oppose the payment being applied to the principal amount of tax. The payment made by Taxpayer should be applied to the principal amount of tax on the date the payment was made or on August 25, 2008.

**Civil Penalty.**

At the hearing, the Department argued that a 20% penalty cap should be applied to the principal amount of tax pursuant to NMSA 1978, §7-1-69 (2008). Department Exhibit #5. (the Department issued its assessment on May 16, 2008 and only applied a 10% penalty to the principal tax.) NMSA 1978, Section 7-1-69 (2003, prior to amendments through 2007) governs the imposition of penalty. Sub-sections A and A(1) of the statute imposes a civil penalty of two percent per month, up to a maximum of ten percent, if a taxpayer fails due to negligence or disregard of rules and regulations to pay taxes in a timely manner. The Department's regulation defining negligence for purposes of assessing penalty is Regulation 3.1.11.10 NMAC. It states as follows:

- 1) failure to exercise that degree of ordinary business care and prudence which reasonable taxpayers would exercise under like circumstances;
- 2) inaction by taxpayers where action is required;
- 3) inadvertence, indifference, thoughtlessness, carelessness, erroneous belief or inattention.

Regulation 3.1.11.10 NMAC.

Whether a taxpayer has acted negligently for purposes of the civil penalty imposed by §7-1-69 (2003, prior to amendments through 2007), is determined as of the date the taxes were due. *See Kewanee Industries, Inc. v. Reese*, 114 N.M. 784, 845 P.2d 1238 (1993) (holding that a modified penalty regulation would not apply retroactively when the regulation was enacted after the applicable tax year). The gross receipts taxes were due at different time periods, but no later than March 2007. Both the 2003 and the 2008 versions of Section 7-1-69 require that the penalty be calculated by month from the date that the tax was due until the cap is reached, not from the date of the assessment or the date that the law changed. There is no indication the legislature intended for

the change to apply retroactively. Therefore, the 10% penalty cap is the correct amount to apply.

At the time the gross receipts taxes were due, Taxpayers had an erroneous belief that it was allowed to take certain deductions. This belief was erroneous and falls within the definition of negligence.

The 10% penalty cap should be applied to the revised principal amount of tax.

**Interest.**

Interest “shall be paid” on taxes that are not paid on or before the date on which the tax is due. NMSA 1978, § 7-1-67 (A). The word “shall” indicates that the assessment of interest is mandatory, not discretionary. *See State v. Lujan*, 90 N.M. 103, 105, 560 P.2d 167, 169 (1977).

The assessment of interest is not designed to punish taxpayers, but to compensate the state for the time value of unpaid revenues. Because the principal amount of gross receipts tax was not paid when it was due, interest was properly assessed.

**CONCLUSIONS OF LAW**

A. Shamrock Foods Company filed a timely written protest to the principal, penalty and interest assessed under Letter ID L2114947456, and jurisdiction lies over the parties and the subject matter of this protest.

B. The deduction of \$1,444.92 for SI Italian Bistro should not be included within the percentage of error calculation because Shamrock Foods Company was able to rebut the presumption that this particular deduction was distinct enough to require the Department to use another invoice from the sample to calculate the percentage of error.

C. The deductions of \$315.90 for Matilda’s and \$553.21 for Abrahams were properly disallowed and properly included within the percentage of error calculation.

D. The proper amount of penalty should be calculated at no more than 10% of the principal amount of tax owed pursuant to NMSA 1978, Section 7-1-69 (2003) before the enactment of the changes to Section 7-1-69, which were effective on January 1, 2008.

E. Interest should be applied to the principal amount of tax due in accordance with this Decision.

F. The payment made by Shamrock Foods Company should be applied to the principal amount of tax as of the date of the payment of August 25, 2008.

For the foregoing reasons, Shamrock Foods Company's protest is GRANTED IN PART AND DENIED IN PART.

DATED: October 21, 2010